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ABSTRACT

Lenders' billings for interest subsidy payments under the Department of Education's Guaranteed Student Loan Program (GSLP) are discussed. In fiscal year 1986, the Department of Education paid lenders $2.4 billion in interest subsidies on $39 billion of outstanding Guaranteed Student Loans. The General Accounting Office (GAO) reviewed the accounts of large lenders to determine (1) the extent of errors lenders make in their billing statements, (2) the cost of these errors in federal overpayments to lenders, and (3) the adequacy of the Department's procedures and internal controls for payment to lenders. All 16 lenders studied made errors in their September 30, 1985, billings on which the Department based payments of $69.4 million. Many errors appear small when viewed individually but are significant when projected to the lenders' total portfolio of Guaranteed Student Loans. It is found that the Department's oversight of billing is inadequate, and lenders lack sufficient incentives to maintain accurate loan accounts. Recommendations are that Congress amend the Higher Education Act to authorize the Secretary of Education to assess lenders' interest on overpayment of interest subsidies due to erroneous billings from the dates of the overpayments and, also to require lenders to have their independent auditors verify loan accounts and interest billings as part of their periodic audits. Five appendices are: loans outstanding for lenders included in GAO's review; interest and special subsidy allowance billed by lenders included in GAO's review, accounts in which lenders miscalculated loan balances or interest due; comments from the Department of Education; and comments from the Consumer Banking Association. Tables and figures are included. (SM)

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United States General Accounting Office

GAO

Report to Congressional Committees

ED 298623

August 1988

GUARANTEED STUDENT LOANS

Lenders' Interest Billings Often Result in Overpayments

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GAO

United States
General Accounting Office
Washington, D.C. 20548

Human Resources Division

B-204708

August 31, 1988

The Honorable Edward M. Kennedy
Chairman, Committee on Labor
and Human Resources
United States Senate

The Honorable Augustus F. Hawkins
Chairman, Committee on Education
and Labor
House of Representatives

This report discusses lenders' billings for interest subsidy payments under the Department of Education's Guaranteed Student Loan Program. The major issue in the report is our finding that the Department's inadequate oversight could be costing the federal government millions of dollars each year in subsidy overpayments.

We are recommending that the Congress (1) authorize the Department of Education to assess lenders interest on overpayments due to erroneous billings from the date of the overpayments and (2) require lenders' independent auditors to verify lender billings as part of their periodic audits.

We are sending copies of this report to the Secretary of Education; the Director, Office of Management and Budget; appropriate congressional committees; and other interested parties.

Edward A Densmore

for Lawrence H. Thompson
Assistant Comptroller General

Executive Summary

Purpose

In fiscal year 1986, the Department of Education paid lenders $2.4 billion in interest subsidies on $39 billion of outstanding guaranteed student loans. These subsidies include all interest on loans while students are in school or during a grace period after they leave school, and a smaller subsidy after students begin repaying their loans. The subsidies are intended to give lenders a near-market rate of return on their loans, while students pay below-market interest rates.

Lenders submit quarterly billing statements for their interest subsidy payments, and the Department pays lenders with minimal verification of their billing calculations.

GAO reviewed the accounts of large lenders to determine (1) the extent of errors lenders make in their billing statements, (2) the cost of these errors in federal overpayments to lenders, and (3) the adequacy of the Department's procedures and internal controls for payments to lenders.

Background

Federal student aid comes primarily from the Department of Education, which administers seven loan, grant, and work-study programs. The Guaranteed Student Loan Program is the largest of these, having underwritten and subsidized $67.6 billion in student loans over its 21-year history. In fiscal year 1986, federal appropriations supporting the program were $3.3 billion.

About 14,000 lenders—banks, savings and loan associations, life insurance companies, and credit unions—make loans that are guaranteed, first by 1 of 58 guaranty agencies, and ultimately by the federal government. In addition to the interest subsidy, these lenders receive a guarantee that they will be paid for loans if student-borrowers default. GAO reviewed one quarter's billing at 16 judgmentally selected lenders. These lenders were among the largest in the program, holding a total of $4 billion of guaranteed student loans, or about 11 percent of all loans. They were geographically dispersed and had diverse loan portfolios and automated loan accounting systems. GAO sampled more than 2,000 loan files at these lenders to determine if supporting loan records and the billing statements they submitted to the Department were accurate.

Results in Brief

The Department of Education's inadequate oversight could be costing the federal government millions of dollars each year in interest subsidy overpayments to lenders in the Guaranteed Student Loan Program. During one 3-month period at 16 lenders GAO reviewed, the Department paid

these lenders $69.4 million in interest subsidies, of which it overpaid at least $1.8 million, net of over- and underpayments, because the lenders submitted erroneous billings.

About 10.3 percent of all loan accounts reviewed had billing errors, and for another 7.8 percent documentation was inadequate to support the amount billed. Although the error rate for these lenders cannot be projected to all program lenders, the extent of such errors in the Department's billing procedures makes it likely that similar errors are made by many lenders.

The Department can charge lenders interest from the date they are notified of the error on overpayments resulting from their incorrect billings. However, the Department lacks authority to charge interest from the date of the overpayment. When coupled with inadequate monitoring and verification procedures, the result is little incentive for lenders to accurately bill for their interest subsidies.

Principal Findings

Lenders Made Errors on Their Billings

All 16 lenders studied made errors in their September 30, 1985, billings on which the Department based payments of $69.4 million. Of the 2,038 loan accounts included in GAO's analysis, 18 percent were in error or lacked adequate documentation to support the amount billed. The causes of these errors varied, but generally resulted from lenders' (1) miscalculating loan principal balances and interest subsidy due and (2) continuing to bill the Department after borrowers began repaying.

The Cost of Erroneous Billings

Many of the errors appear small when viewed individually; however, they become significant when projected to the lenders' total portfolio of guaranteed student loans. Based on the 16 lender-submitted billing statements, and the rate of errors the lenders made during the 3 months ending September 30, 1985, GAO estimates that the Department overpaid these lenders at least $1.8 million for the quarter. Three of these lenders have voluntarily repaid the Department $345,071 in interest subsidy overbillings pertaining to that and other recent billing periods.

The Department's Oversight of Billing Is Inadequate

The Department relies on lenders to maintain current and complete loan files, submit accurate billings, and make adjustments promptly. Billing statements submitted to the Department show only summary information, such as total loans eligible for interest subsidies at the various interest rates charged borrowers. Lenders submit no supporting documentation with their billings because it would be too voluminous for the Department to validate. The Department's verification, therefore, is limited to checking the mathematical accuracy and reasonableness of the summary calculations and whether the billing form has been properly completed. The Department recognizes that this process does not detect errors in individual accounts underlying the billings.

The Department conducts on-site lender reviews of the documentation retained in support of the billings. The number of lenders visited is limited by the availability of staff and travel funds. While such reviews could detect errors in individual borrower accounts comprising the billings, the scope of the work is narrow and the duration of review is short.

In fiscal year 1986, of the 14,000 lenders participating in the program, fewer than 500 underwent on-site reviews. During these visits, the Department typically reviews about 30 judgmentally selected accounts at each lender. Since these kinds of samples are inadequate to project to the total population of accounts on each billing, recoveries of overpayments are often made only for the accounts found in error. The Department had reviewed 4 of the 16 lenders included in GAO's analysis, and none of the site visit reports disclosed the kind of errors GAO identified.

Lenders Lack Sufficient Incentives

The Higher Education Act does not authorize the Department to assess interest from the dates of overpayments to lenders who make errors and overbill the Department. Lenders are expected to maintain accurate loan accounts; prepare timely, complete, and accurate billing statements; and identify errors and make adjustments when errors are found. However, if lenders overbill the Department, no interest can be charged on the overpayments until the errors are detected and the lenders notified, although, in certain extreme cases, civil penalties can be assessed or their participation in the program can be limited, suspended, or terminated. Since lenders can thereby be provided the use of interest-free funds until the errors are found and corrected, they lack sufficient incentives to bill accurately.

Recommendations

GAO recommends that the Congress amend the Higher Education Act to (1) authorize the Secretary of Education to assess lenders interest on overpayments of interest subsidies due to erroneous billings from the dates of the overpayments and (2) require lenders to have their independent auditors verify loan accounts and interest billings as part of their periodic audits.

GAO makes several recommendations to the Secretary of Education to revise the Guaranteed Student Loan Program regulations to provide for developing audit standards for the guaranty agencies to use in reviewing lenders, and verifying loan accounts and interest and special allowance billing to detect and recover interest subsidy overpayments.

Agency Comments

The Department of Education said that our recommendations, when combined with other initiatives, would improve oversight of lenders and reduce billing errors. (See app. IV.) The Consumer Bankers Association also agreed in general with our report. (See app. V.) We addressed these comments in the report (see p. 27) and made changes where appropriate.

Contents

Executive Summary		2
Chapter 1 Introduction		8
	Guaranteed Student Loans	8
	Interest and Special Allowance Subsidy Payments to Lenders	9
	Lender Billings	9
	Objectives, Scope, and Methodology	11
Chapter 2 Lenders' Errors Resulted in Overpayments		14
	Errors in Lenders' Loan Records and Billing Practices	14
	Lenders' Errors in Billing Statements	17
	Conclusion	19
Chapter 3 What Can Be Done to Reduce Billing Errors?		20
	Department of Education Oversight Is Inadequate	20
	Guaranty Agencies to Have a More Active Role in Oversight of Lenders	24
	Authority Needed to Assess Interest on Overpayments	25
	Billing Error Problems Identified in Secretary's FMFIA Report	26
	Conclusions	26
	Recommendations to the Congress	27
	Recommendations to the Secretary of Education	27
	Agency Comments and Our Evaluation	27
Appendixes		
	Appendix I: Loans Outstanding for Lenders Included in GAO's Review (As of Sept. 30, 1985)	32
	Appendix II: Interest and Special Subsidy Allowance Billed by Lenders Included in GAO's Review (for the Quarter Ending Sept. 30, 1985)	33
	Appendix III: Accounts in Which Lenders Miscalculated Loan Balances or Interest Due	34
	Appendix IV: Comments From the Department of Education	35
	Appendix V: Comments From the Consumer Bankers Association	40

Tables

Table 2.1: Individual Borrower Accounts in Which Lenders Made Billing Errors or Lacked Adequate Documentation 14
Table 2.2: Reasons 10 Lenders' Billing Statements Were in Error 18

Figures

Figure 1.1: Major Federal Costs of the Guaranteed Student Loan Program 10
Figure 1.2: Department of Education Interest and Special Allowance Subsidy Payments (Fiscal Years 1980-87) 11

Abbreviations

FMFIA	Federal Managers' Financial Integrity Act
GAO	General Accounting Office
GSLP	Guaranteed Student Loan Program
OIG	Office of Inspector General

Introduction

The Guaranteed Student Loan Program (GSLP) is the largest federal program providing student financial assistance. Under this program, lenders make loans to postsecondary students that are guaranteed against default by state guaranty agencies, which are reinsured by the Department of Education.

Program lenders have two incentives to make loans. First, in general the risk of loss is relatively low, since the loans are guaranteed against nonrepayment by the federal government. Second, the loans are profitable, since they carry a fixed rate of interest (new loans are made at 8-percent interest) plus an interest subsidy called a special allowance to give lenders a variable rate of return that approximates market rates. The Department pays the interest as a subsidy while the student is in school and the special allowance through the life of the loan. In fiscal year 1986, the Department paid lenders $2.4 billion in interest and special allowance subsidies.

Guaranteed Student Loans

The Department of Education administers seven student aid programs under title IV of the Higher Education Act of 1965, as amended (20 U.S.C. 1071). GSLP is the largest federally assisted student aid program. Over its 21-year life, GSLP has accounted for $67.6 billion in loans and required $24.1 billion in federal appropriations. In fiscal year 1986, new loans made totaled $8.6 billion.

Each guaranteed student loan involves five parties. A lender makes the loan to a student borrower attending an institution of higher education. A state or private nonprofit guaranty agency guarantees the loan against nonrepayment. The Department of Education subsidizes each loan by reimbursing claims for defaulted loans to the guaranty agency and by paying interest subsidies to the lender.

The Department has overall responsibility for administering the program, but guaranty agencies are given considerable discretion in designing and operating their programs within broad federal rules. As many as 14,000 lenders are eligible to make loans to students at about 8,000 schools. In fiscal year 1986, lenders made 3.4 million loans guaranteed under the program.

Interest and Special Allowance Subsidy Payments to Lenders

The Department estimates that as of September 30, 1986, $39 billion in outstanding loans were subject to interest and special allowance subsidies, for which federal appropriations were $3.3 billion. In fiscal year 1986, the Department paid lenders about $1.6 billion in interest and $779 million in special allowance, totaling about $2.4 billion, or about two-thirds of all federal funds for GSLP. The remaining federal costs were primarily for reimbursement of claims for defaulted loans. (See figure 1.1.)

The interest rate paid lenders on guaranteed student loans is established by formula in the Higher Education Act. The rate students pay has been 8 percent on new loans since September 1983, with older loans having interest rates at 7 or 9 percent. The Department pays all interest on loans while the student is in school, during a 6-month grace period, or during an authorized period of deferment. Once students leave school, they begin to pay interest, generally over a payback period of up to 10 years.

The special allowance is a quarterly supplemental interest subsidy payment intended to raise the lender's return to a competitive level. The special allowance payment, which is computed on the lender's outstanding balance of all loans at each interest rate, is the difference between the loans' interest rate and the 91-day Treasury bill rate (computed quarterly) plus 3.25 percent.

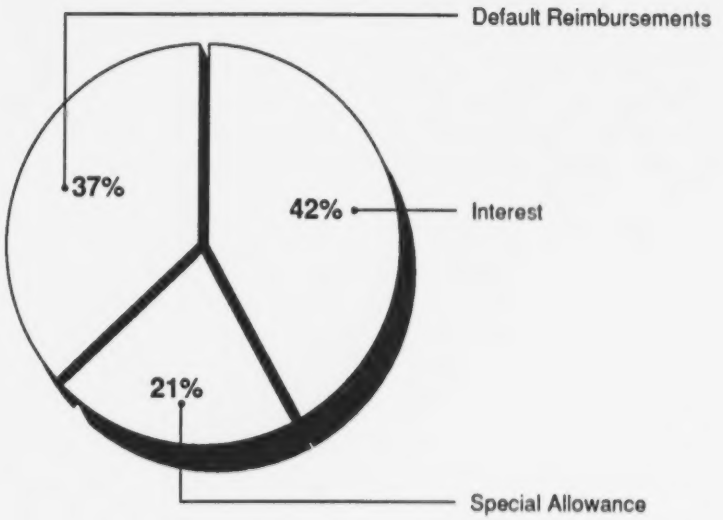
The amount paid lenders in interest and special allowance subsidy in any period depends on (1) the number and amounts of loans outstanding; (2) the students' status, e.g., in school or having begun repayment; and (3) the Treasury bill rate. As shown in figure 1.2, the interest and special allowance payments have varied considerably since 1980, and special allowance payments have declined substantially due to lower Treasury bill rates in 1986 and 1987.

Lender Billings

The Department of Education generally pays the interest and special allowance subsidy directly to lenders based on billing statements they submit. In some instances, guaranty agencies submit consolidated billings to the Department for several of their lenders.

The billing statement is generally submitted quarterly on the Department's form 799—Lender's Request for Interest and Special Allowance. Lenders or guaranty agencies use the form to report four elements of information used to determine the payment: (1) loans outstanding

Figure 1.1: Major Federal Costs of the Guaranteed Student Loan Program



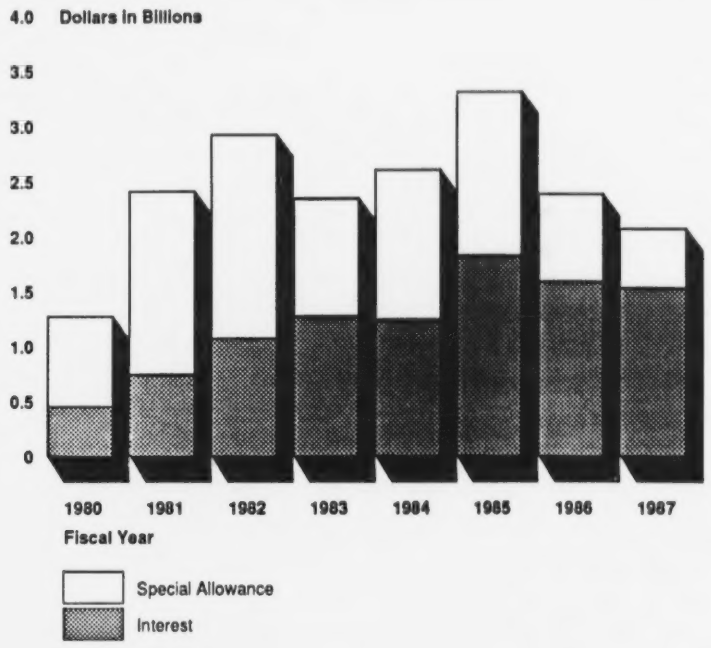
(either actual or average balances) at each interest rate eligible for federal interest subsidy payments, (2) loans outstanding at each interest rate eligible for special allowance, (3) adjustments due to interest and special allowance balances inaccurately reported on previous billings, and (4) the origination fees[1] lenders withheld from borrowers on new loans made during the billing period, plus any adjustments related to these fees.

The Higher Education Act, federal program regulations, and instructions provided by the Department give the lenders guidance in preparing and submitting their billing statements. Lenders submit their billing statements to the Department, where they are processed by a contractor at its Student Loan Processing Center.

The Department checks all billings for accuracy and subjects them to limited tests and edits to identify obvious errors. After the Department verifies the accuracy of the lender's interest calculation, computes the special allowance, and makes any adjustments, it determines the total amount of interest and special allowance subsidy due a lender. Lenders

[1]The loan origination fee is a rate fixed by law that the federal government charges lenders for new loans guaranteed.

Figure 1.2: Department of Education Interest and Special Allowance Subsidy Payments (Fiscal Years 1980-87)



do not provide documentation to support their billings, although they are required to maintain such data.

Objectives, Scope, and Methodology

One of our objectives was to determine whether the Department of Education is incurring excessive costs related to its payment of interest and special allowance subsidies to lenders. Specifically, we wanted to know the extent to which

- lenders make errors in billing the Department for interest and special allowance payments,
- lender billing errors result in federal overpayments, and
- the Department has established adequate systems and procedures to detect lender billing errors and prevent overpayments.

We also wanted to know if the Department's systems and procedures are adequate to detect billing errors and prevent overpayments and, if so, whether internal control weaknesses were identified by program managers and included in the Secretary of Education's annual report to the

President and the Congress as required by the Federal Managers' Financial Integrity Act (FMFIA).

We performed our work at the Department's headquarters in Washington, D.C., and at 16 judgmentally selected lenders or their billing agents in 6 states—California, Florida, Georgia, Illinois, Michigan, and New York. We did not randomly select lenders nationwide because the complexities of verifying billings and the large number of lenders would make such an approach extremely costly.

We chose the 16 lenders for the following reasons:

- They were geographically dispersed and represented the various types of organizations eligible to participate in the program. We analyzed records at seven banks, three savings and loan associations, a life insurance company, two state agencies, a credit union, and two billing agents for the Student Loan Marketing Association—the national secondary market for student loans. Each of these organizations operates as a lender in the program because it makes, services, or holds guaranteed student loans. (See app. I for the amount of guaranteed loans outstanding for each of the 16 lenders.)
- They had a large number of guaranteed student loans outstanding. They held about $4 billion (10.9 percent) of the $36.8 billion in loans outstanding at the end of fiscal year 1985, the latest date information was available for analysis. Each lender had a loan portfolio of at least $10 million and ranked among the largest 500 lenders in terms of volume. (See app. II for the interest subsidy each of the 16 lenders billed the Department for the quarter ending Sept. 30, 1985.)
- Their systems and procedures for computing billings for interest and special allowance varied widely. However, each of the lenders used some automation in its billing system.

At each lender, we determined how it calculated the billing submitted to the Department, reviewed supporting loan records, determined the accuracy of the information reported on the billing form, and verified a sample of the billings submitted for the quarter ending September 30, 1985. Where we found recurring errors, we reviewed prior and subsequent billings to determine the cause and any needed corrective actions and contacted guaranty agencies to obtain their comments and help ensure the corrections were made.

We determined the accuracy of the billings in accordance with requirements in the Higher Education Act, federal regulations, and the Department's billing instructions. We verified the loan balances and interest calculations on each billing by tracing them to supporting documentation maintained by the lenders on 2,038 randomly selected loan accounts. We also discussed our findings and conclusions with the lenders and with Department officials.

We projected the rate of errors we found to the loan portfolios of each lender reviewed. However, we excluded from our projections amounts for which documentation was missing because we could not determine the amount, if any, of such errors. Thus the errors we found likely understate the overpayments. Because we selected lenders judgmentally, we cannot project our results to all program lenders.

At Department headquarters, we interviewed officials and obtained documents to determine how the Department processes and pays lenders' interest and special allowance billings and the controls it has to ensure accuracy. We obtained copies of procedures and reports on the Department's periodic reviews of lenders, including those of the Office of Inspector General (OIG).

During our review, the Department contracted for a study on the appropriateness of certain payments it makes under GSLP. One of the areas included was lender billings for interest and special allowance subsidies. We reviewed the contractor's draft report and considered its findings in our analyses.

We conducted our analyses between April and October 1986. To the extent possible, we report program-wide data as of the end of fiscal year 1986. Also, we considered legislative and regulatory changes, as they affect lender billing practices, through January 1988.

Our review was made in accordance with generally accepted government auditing standards.

Lenders' Errors Resulted in Overpayments

The Department of Education overpaid the 16 lenders we reviewed at least $1.8 million of the $69.4 million paid in interest and special allowance subsidies for the quarter ending September 30, 1985, because of lenders' errors in their billings. The lenders

- miscalculated borrower loan balances or interest due and
- continued to bill the Department for interest subsidies after borrowers began loan repayments.

Because we judgmentally selected the lenders we reviewed, the error rate (10.3 percent of all accounts) can be projected only to those lenders. However, if the error rate by these lenders—which held about 11 percent of all outstanding guaranteed loans at the end of fiscal year 1985—is being experienced by lenders in general, the potential for overpayment is substantial considering that the Department paid $2.4 billion in interest subsidies in 1986.

For an additional 7.8 percent of the accounts we reviewed, lenders failed to keep adequate records to support borrower loan balances. As of November 30, 1987, 3 of the 16 lenders had repaid the Department—through billing adjustments—$345,000 in overpayments resulting from our work.

Errors in Lenders' Loan Records and Billing Practices

We reviewed the lenders' files for 2,038 randomly selected loan accounts included in the 16 lenders' billings for the quarter ending September 30, 1985. Table 2.1 categorizes the errors we found.

Table 2.1: Individual Borrower Accounts in Which Lenders Made Billing Errors or Lacked Adequate Documentation

Type of error	Number of accounts	Percent of sample accounts
Miscalculation of loan balance or interest due	177	8.7
Failure to make proper adjustments	32	1.6
Inadequate supporting records	158	7.8
Total	**367**	**18.1**

In the files we reviewed, lenders made errors in calculating loan balances or interest subsidy due, and made improper adjustments to loan accounts. These errors resulted in both overpayments and underpayments to lenders. Statistical projection of these errors to these lenders'

quarterly billings yields an estimate of $1.8 million in Department overpayments to these 16 lenders. Because lenders did not maintain adequate supporting records on 158 accounts, we were unable to determine the accuracy of the amounts billed for those accounts.

Also, one lender and one guaranty agency (which prepares billings for lenders for which it guarantees loans) identified weaknesses in their billing systems as a result of our work. That lender voluntarily returned $80,452 to the Department in overpayments, some of which pertained to other recent billing periods as well as the period we reviewed. The guaranty agency was determining the extent of overpayments to all 380 of its lenders when we completed our fieldwork.

Lenders Miscalculated Loan Balances and Interest Due

There were a variety of reasons why lenders had miscalculated either the outstanding loan balance or the interest due on about 9 percent of the sample loan accounts reviewed. (See app. III.)

Six lenders under- or overstated the outstanding principal balances on 2.3 percent of the accounts in our sample (47 of 2,038), resulting in net federal overpayments of $2,240. For example, one lender erroneously included loans in its billing for borrowers who were not in school as "in-school." Under the program, while borrowers are attending school and during the grace period (6 to 12 months) after leaving school, the Department pays the lender interest on the loan. The lender's accounts showed that these borrowers had left school and begun repaying their loans. The lender was, therefore, ineligible for federal interest payments.

Interest due lenders was inaccurately calculated on 6.4 percent of the accounts. These included both under- and overpayments. Net overpayments to lenders totaled $5,811. For example, for 27 of these loans, the Department of Education overpaid seven lenders about $3,800 in interest subsidy because they used incorrect effective dates for borrower deferments. After our review, one of the lenders reviewed all of its accounts for this problem and identified a systemic problem in its treatment of borrower deferments, which it corrected by revising its computer program.

Lenders Failed to Make Required Adjustments

When a borrower's grace period or payment deferment expires, the Department of Education requires lenders to cease billing for subsidized interest because the borrower is responsible for paying interest and

principal. Lenders must often adjust their billings for any subsidized interest payments received after a borrower's repayment period begins due to time lags in the quarterly billing cycle. This occurs principally because borrowers' payments are received or posted after lenders prepared their quarterly billing statements or lenders are late in posting loan payments to their loan accounts.

In our sample, 711 borrowers had begun repaying their loans. For 8 percent of these accounts (56 of 711), lenders billed the Department for interest after students began to pay—in two cases 356 and 608 days after receiving a loan payment. For about half of these 56 accounts (24 accounts), the lenders later made the required billing adjustments. However, lenders had not made the required adjustments for the other 32 accounts, which we calculated resulted in the Department overpaying lenders about $3,400. For example, one lender inappropriately continued to bill the Department for interest on 11 of 50 sampled loans (22 percent) for up to 608 days after the borrowers had left school and began repaying their loans. This resulted in the Department overpaying the lenders about $2,000 in interest. After we brought this situation to the lender's attention, it made adjustments to seven accounts and was determining the needed adjustments for the other four.

Lenders Did Not Maintain Supporting Documentation

The Department of Education requires lenders to keep complete and accurate records organized in a manner to permit ready identification of each loan's current status, and from which the amounts billed can be derived. These files are to document any transactions, including interest calculations and the billings.

We found that lenders' record-keeping practices often fell short of these requirements. The loan files for 158 (7.8 percent) of the accounts reviewed contained, in our opinion, inadequate documentation to support the subsidized interest and special allowance claims, or adjustments on the lenders' billings statements. For example:

- At one lender, the files for 34 percent of sampled accounts lacked evidence of the borrower's enrollment status. Consequently, we were unable to verify, and the lender was unable to show us, whether these borrowers were eligible for interest subsidies.
- Twenty-eight percent of another lender's accounts (14 accounts) lacked evidence to support whether these loans were guaranteed under the program, or whether the principal balances used to bill the Department

were accurate. Four of 50 files were missing altogether, including the borrowers' promissory notes.

The lenders' failure to retain appropriate documentation for loans does not necessarily mean that the lenders' billing statements or payments were incorrect; therefore, we excluded these cases in estimating the amount of erroneous payments in table 2.1. Federal regulations, however, require lenders to bill only for those amounts their records support. Thus, if the Department knew that the lenders' billings were not adequately supported, it could have denied payment on the amounts billed (up to $5 million on the cases we reviewed). The denial of a lender's billing is the only sanction available to the Department to penalize lenders who fail to follow procedures.

Department Identifies Problems With Interest Billing Practices

The Department of Education's own studies of lenders' billings for interest and special allowance support our findings of erroneous payments to lenders. For example, a 1986 Department quality control study analyzed fiscal year 1984 billings by 313 lenders.

The study found problems similar to those we identified, such as mistakes in interest subsidy computations, improper methods of deriving loan balances, clerical errors, billing for ineligible loans, and missing documentation. The study reported that about 20.1 percent of lenders' payments from the Department for interest and special allowance were incorrect. Most of the errors identified in the study were attributed to missing records in lenders' files, which raised questions about the validity and significance of the findings. A Department official said that the Department generally agrees with the study's conclusions and it has begun to address the problems identified.

Lenders' Errors in Billing Statements

To determine if lenders were accurately billing the Department of Education for interest subsidies, we analyzed billing statements the 16 lenders submitted for the quarter ending September 30, 1985. Ten of the 16 statements were incorrect for the three reasons presented in table 2.2.

Table 2.2: Reasons 10 Lenders' Billing Statements Were in Error

Error	Number of statements containing errors[a]
Overstated loans eligible for subsidized interest	3
Incorrect principal balances for loans eligible for subsidized interest and special allowances	5
Loans billed at incorrect interest rate category	9

[a]Some lenders made more than one kind of error.

The following examples illustrate errors lenders made in preparing their billing statements.

Example 1. The principal balances reported by two lenders included loans that were ineligible for subsidized interest payments. One lender's computer system classified about $710,000 in loans as "in-school" (i.e., students attending school and not yet repaying their loans) and eligible for interest payment, when the loans were actually being repaid by students. After we brought the error to the lender's attention, it refunded the Department $61,517 in overpayments. In the other instance, the lender's balance included about $21,500 in loans that were subsidized by a private foundation rather than the federal government. The lender had overbilled the Department for about $400 in interest on these loans.

Example 2. Another lender (1) failed to make adjustments for overbillings in previous quarters, (2) erroneously added the amount of origination fees it collected from borrowers to the loan balances it used to determine the amount billed the Department for interest subsidies, and (3) made other calculation errors. After discovery, the lender recalculated its billing and repaid the Department $165,030.

Example 3. Another lender was overpaid about $38,000 during the 2 years preceding its September 30, 1985, billing because it billed the Department for about 3,200 guaranteed loans for which borrowers never cashed the lender's checks. Some of these uncashed checks were outstanding for as long as 3 years. This lender started billing the Department immediately after issuing the checks, and had no policy for canceling uncashed checks. Furthermore, two guaranty agencies paid this lender default claims on certain of these unused loans totaling about $118,000. After we told the lender of the problem, the lender returned $38,072 in overpaid interest and special allowance subsidies to the Department and is in the process of repaying or canceling the default claims.

Conclusion

The lenders we reviewed made errors in interest subsidy billings totaling $1.8 million for one quarter. Recognizing that the lenders we analyzed were among the largest lenders participating in the program, it is likely that similar errors are made by other lenders.

What Can Be Done to Reduce Billing Errors?

The Department of Education fails to detect many billing errors by lenders. Because documentation is voluminous, lenders need to report only summary information to the Department in support of each billing. The Department relies on the lenders to retain adequate documentation and submit billings that are accurate, but has only a limited system of billing test checks and infrequent on-site review. The Department visited only 5 percent (660) of all lenders in 1985, and fewer than 500 in 1986. Furthermore, lenders have limited incentives to take the steps needed to prepare accurate billings, in part because the Department lacks the authority to begin charging interest on overpayments resulting from inaccurate lenders' billings until after it detects the errors and notifies the lenders.

The Department needs to improve its oversight of lenders' internal control systems and billing practices. In addition, the Department should have authority to assess interest on overpayments to lenders resulting from erroneous billings from the dates of such payments.

Department of Education Oversight Is Inadequate

Each quarter, the Department of Education processes interest and special allowance billings for as many as 14,000 participating lenders or their servicers. At the end of fiscal year 1986, these lenders' portfolios included an estimated 20 million loans with a total outstanding principal balance of $39 billion. After receipt of billing statements, the Department must process and pay them within 30 days. Otherwise, the Department must pay lenders an interest penalty for late payments on lender billings.

Due to the large volume of billings and the processing time constraint, the Department does not require lenders to submit detailed documentation for the amounts claimed with their billing statement. Lenders are, however, required to retain such supporting records. To determine the accuracy of these interest billings, the Department uses two procedures: (1) it subjects the information included on each billing to certain validation checks before payment, and (2) it performs periodic on-site reviews of lenders.

Prepayment Checks Do Not Detect Most Billing Errors

The Department of Education subjects lender interest billing statements to both manual and automated validation checks. Initially, Department personnel manually verify that all the required data items on the billing form have been completed. For example, if a billing form does not show

entries for the "Billing Period Ending" or the "Billing Method," it is considered incomplete and returned to the lender for correction.

The billing statements passing these initial manual checks are keypunched into the Department's computerized payment system. Statements for lenders requesting payments of $10 million or more and for certain nonprofit lenders are processed and paid manually.

Billings entered into the computerized system are then subjected to three different checks.

1. The system verifies that the lender is eligible to receive payments by comparing each lender to a list of lenders approved to participate in the program. It also verifies that all data items are complete and logical. For example, the Department should reject a billing if the lender's statement showed a quarterly bill, when it was filing an annual or semiannual statement. The system also verifies that the lender's interest calculations are based on lender-reported summaries of outstanding balances.

2. The system compares the billing statement with a file of the lender's previous billings to determine whether the lender had submitted a previous billing for the same payment period.

3. The system runs "reasonability checks" against the statement's data. One check, for example, compares the lender's balance of loans subject to interest payments with the number of loans eligible to receive special allowance. Because all loans on which interest is payable are also eligible for special allowance, the ratio of the interest to special allowance balances should never exceed one-to-one.

At the 16 lenders, we determined how effectively the Department's existing controls identified lender errors. We found that, although the Department's billing statement checks identified some errors, at the 16 lenders the checks did not detect and prevent the kinds of billing errors we found. None of the errors we found at these lenders—some of which had resulted in substantial overpayments—had been identified by the Department.

One aspect of lenders' billing practices for which the Department's system checks were particularly ineffective was the "interest adjustment." Interest adjustments occur principally when students enter into a loan repayment period and begin making interest and principal payments. Such adjustments were responsible for 9 percent of the billing errors we

identified, and are attributed in part to complexities of the billing process (i.e., large volume of small loans entering repayment, becoming delinquent, and being declared in default). The 16 lenders made 32,000 adjustments in their September 30, 1985, billings submitted to the Department. The Department relies on lenders to maintain the documentation to support their adjustments, and the Department's checks are not designed to identify interest adjustment errors.

A method of verifying lenders' interest adjustments is needed and feasible, and should be added to the Department's system checks. Students' school enrollment status changes because they leave school, change jobs, or request deferments, and most lenders would show some level of interest adjustments on their quarterly billings. Interest adjustments are expected and are normal practices for lenders preparing their quarterly billings. However, we found instances in which lenders' billings contained no adjustments for several quarters. Therefore, one test the Department could make would be to verify that lenders had an entry in the interest adjustment item on the billing statement. The absence of adjustments would be one indicator of a possible error, and the Department could follow up with lenders whose billings continually contain no adjustments.

For example, our review showed that lenders were often late in posting to loan accounts when student-borrowers began to repay, which was a major reason for them to make adjustments for overbilled interest. One lender in our review had a loan portfolio of about $22.5 million (about 10,000 accounts), and its billing statement contained no interest adjustments. We found that about 6 percent of the sample loan accounts reviewed at this lender required an overbilling adjustment. The Department paid the lender without questioning the absence of adjustments during the quarter we reviewed.

According to Department officials, the program's system of checks is insufficient to detect most lender errors other than the most obvious ones. They said that its automated billing payment system is being upgraded to incorporate stronger controls and improved checks and tests. On November 10, 1987, the Department awarded a contract to National Computer Systems, Inc., for computer services related to GSLP and the Perkins Student Loan program. One part of the contract covers the processing and payment system for lender billings for interest and special allowance. The contractor is to design and develop a system that will include various checks and edits, many of which are consistent with

the recommendations made in the Department's recently completed contracted study (see p. 13). The revised system is to be in place by October 1, 1989. Since the contractor recently began designing the revised system, it was too early for us to evaluate the proposed revisions.

Compliance Reviews Are Often Infrequent and of Limited Scope

The other oversight tool the Department uses is periodic on-site lender reviews. The scope of these reviews, which cover the full spectrum of compliance with program rules, includes an analysis of the records and documentation lenders retain to support the amount of interest billed the Department.

The Department lacks a lender audit strategy and performs on-site reviews at a small percentage of lenders. The duration and scope of these reviews are also limited by the number of regional office staff available to review the various title IV programs. In fiscal year 1985, for example, it completed reviews of 660 lenders—about 5 percent of those participating in the program. In fiscal year 1986, it completed fewer than 500 lender reviews and cited a reduction in travel funds as a reason for the reduction.

In addition, lender reviews, which generally last between 1 and 5 days depending on the lender's size, are limited in scope. The reviews include an assessment of the lender's operations in making, disbursing, and collecting loans; filing default claims; and billing for interest. The reviews are generally accomplished through an analysis of about 30 borrower files. These files are usually selected judgmentally; consequently, any adjustments are recommended solely for the errors found in the samples, and the Department cannot statistically project the significance of the problems or their monetary effect on the lenders' entire guaranteed student loan portfolio.

We reviewed a sample of the Department's lender review reports and found that they typically identified such problems as lenders using incorrect loan account balances, including loans that were in repayment, and failing to use the correct interest rate. For the 16 lenders we analyzed, only 4 had been visited within the past 3 years, and none of the site visit reports disclosed the kind of errors we found.

A Department official said that personnel constraints prevent more frequent and thorough lender reviews. The official said that these reviews did little to solve program-wide problems related to lenders' billing practices and the Department's payment system because of their limited

scope and design methodology. The official said that the Department is beginning to implement more statistical sampling techniques in its audit guides, and that this should help improve the design methodology and scope of its lender review activities.

Guaranty Agencies to Have a More Active Role in Oversight of Lenders

The Higher Education Amendments of 1986, which reauthorized title IV of the Higher Education Act in October 1986, and the Department of Education's revised regulations issued in November 1986 provided additional procedures that should improve the administrative and fiscal controls and oversight of lender operations. One major change requires guaranty agencies to perform reviews of lender operations, and gives the agencies increased authority to suspend and terminate from the program lenders that violate the law's provisions. Although some of these procedures apply to how lenders bill the Department for interest subsidies, it is unclear how they will be implemented by the lenders and the Department.

The revised regulations require each guaranty agency to conduct comprehensive on-site reviews every 2 years of (1) each lender whose loan volume guaranteed by the agency exceeded 2 percent of its total guarantees in the preceding year or (2) at a minimum the 10 largest lenders whose loans the agency guaranteed in that year. Also, the regulations require the agencies to seek prompt repayment of interest subsidies improperly received by the lenders identified during the reviews and to monitor implementation of lender plans required to correct their billing practices.

Before these provisions, the Department prohibited the agencies from reviewing the accuracy of lender billings because the Department paid interest directly. Under the revised regulations, lenders continue to bill and receive interest payments from the Department, but agencies have a role in ensuring that billings are accurate. However, these requirements provide little guidance for the agencies' use in performing their lender audits and reviews. For example, the Department's regulations require the Office of Inspector General to develop audit guidelines for the guaranty agencies to use in biannual audits of their own activities. However, there is no similar requirement for audit standards for the agencies to use in reviewing lender activities. Without such audit guides, the Department has no assurances that the audits and reviews will be conducted uniformly and consistently, that they specifically cover lenders'

billing practices, or that appropriate action will be taken to correct deficiencies. Therefore, we believe the Assistant Secretary for Postsecondary Education should develop such standards with assistance from OIG.

Guaranty Agencies' Audit Coverage of Lenders Is Insufficient

The Department's Guaranteed Student Loan Program office issued a Lender Site Review Guide in fall 1987 for guaranty agencies to use in conducting their on-site reviews at lenders participating in the program. The guide discusses the criteria the agencies can use in measuring lenders' compliance with the law and regulations. However, further guidance is needed to specify other requirements for the agencies' lender audits. For example, the Department should direct the guaranty agencies to include in their audits statistical sampling of borrower accounts to identify errors in lenders' loan accounts and interest and special allowance billings, and to use in projecting erroneous billing for future recovery from lenders that overbilled the Department.

We believe that a more effective way to ensure that lender loan accounts and interest and special allowance billings are subject to periodic audit would be to include these billings in the scope of lenders' independent audits. Lenders are required by state and federal bank regulatory agencies to have independent auditors perform periodic (generally annual) audits of their financial activities. Lenders could be required to specify that their auditors include, as a minimum, a verification of student loan accounts and a test of the accuracy of the lenders' interest billings to the Department. Any errors identified could then be promptly reported to the Department and the appropriate guaranty agency so that corrections could be made.

Authority Needed to Assess Interest on Overpayments

When the Department of Education determines that a lender has received an overpayment, it requires that lender to repay the overpayment, and can assess interest on the overpayment from the date it notifies the lender. If the Department determines that the overpayment is material and resulted from (1) a clear and consistent pattern of violations, failures, or substantial misrepresentations, (2) gross negligence, or (3) willful actions by the lender, it can impose civil penalties of up to $25,000 for each occurrence. Furthermore, lenders can be limited, suspended, or terminated from participating in the program for substantially failing to submit accurate billings. According to a Department program official, such penalties and sanctions have never been imposed by the Department. However, the Department lacks authority to charge lenders interest for the period from the date of overpayment until it

notifies the lenders to repay. Because lenders' billing errors are frequently undetected and they incur no interest charges until they are notified to repay the overpayments, lenders lack sufficient incentives to ensure that billings for interest subsidies are accurate.

To encourage lenders to maintain accurate loan documentation, prepare accurate billings, and make adjustments to loan accounts such as when students began repayment, the Department should have legislative authority to charge lenders interest for amounts overbilled from the dates of the overpayments. The interest rate could, for example, be the same as the Department must pay when it is late paying lenders. The rate is determined in accordance with the Higher Education Amendments of 1986 and is adjusted quarterly.

Billing Error Problems Identified in Secretary's FMFIA Report

In the Department's fiscal year 1987 FMFIA report to the President, the Secretary of Education identified two material internal control weaknesses related to guaranteed student loan interest subsidy payments. Supporting documentation for the report noted that an internal review of fiscal year 1984 records identified (1) interest subsidy billing errors of $121 million due to lenders' overstatements of loan account balances and incorrect classifications of loan and student status, and (2) missing documentation in lenders' files for individual borrower accounts associated with $417 million of payments. According to the Secretary's report, corrective actions and related completion dates had yet to be determined.

Conclusions

To better detect errors in lenders' interest subsidy billings and recover overpayments, the Department's oversight of lenders should be improved by

- clarifying that the scope of guaranty agencies' biennial audits include lender practices for maintaining loan accounts and preparing their quarterly interest subsidy billings to the Department, and
- requiring that participating lenders have their independent auditors include loan account and interest billing verification in their periodic independent audits.

In addition, to give lenders an additional incentive to accurately bill for interest subsidies, the Department should be able to charge lenders interest due to billing errors from the date of overpayment.

We believe such actions should improve the Department's oversight of lenders and help correct the material internal control weaknesses identified in the Department's 1987 FMFIA report.

Recommendations to the Congress

We recommend that the Congress amend the Higher Education Act to

- authorize the Secretary of Education to assess lenders interest due to lender billing errors from the date of overpayment of interest and special allowance.
- require lenders to (1) specify to their independent auditors that the verification of loan accounts and interest and special allowance billing be included in periodic independent financial audits and (2) provide that errors identified are promptly reported to the Department and guaranty agency.

Recommendations to the Secretary of Education

We recommend that the Secretary revise the Guaranteed Student Loan Program regulations to

- require the Office of the Inspector General to assist program officials in developing audit standards for the guaranty agencies to use in reviewing lender billing systems and practices.
- stipulate that Department and guaranty agency audits of lenders include tests of the accuracy of lender loan accounts and billing statements to provide a statistically valid basis for recovering overpayments.

Agency Comments and Our Evaluation

The Department of Education and the Consumer Bankers Association provided comments on a draft of this report. We also gave the National Council of Higher Education Loan Programs an opportunity to comment on the draft report, but it did not provide comments.

Department of Education Comments

The Department generally believed that our recommendations, in conjunction with other Department initiatives, would improve its ability to discover and reduce billing errors by lenders. However, it took exception to our characterization that the lender reviews the Department and the guaranty agencies conducted were inadequate. The Department stated that its regulations requiring guaranty agencies to review major lenders, its Lender Site Review Guide, and its guaranty agency training activities have enhanced the lender review process.

The Department revised its regulations for guaranty agencies' lender reviews in November 1986 and issued the review guide in the fall of 1987. While these actions should improve the oversight process, there has been insufficient time to assess their effectiveness in reducing billing errors. Moreover, as we noted in the report, these regulations and guide provided insufficient guidance to guaranty agencies for conducting lender audits and reviews—for example, they did not require guaranty agencies to use statistical sampling techniques to project and recover overpayments. As discussed below, the Department has agreed to require the agencies to use such techniques, which should enhance the Department's ability to recover overpayments and provide stronger incentives to lenders to prepare accurate billings.

The Department did not oppose our recommendation that the Higher Education Act be amended to authorize it to assess interest on overpayments due to lenders' billing errors. The Department believed it already has such authority but that it is not specifically contained in the program statute. However, this authority (31 U.S.C. 3717) applies only to the period after the Department detects the error and notifies the lender to repay. We believe such authority should apply from the date of overpayment to give lenders more incentive to prepare accurate interest billings.

The Department also recommended that we support its proposal to repeal a provision in the Higher Education Act allowing lenders to avoid penalties for violating program requirements by correcting the violations before the Department initiates action. The Department's proposal, however, refers only to civil penalties for violations and would not apply to its authority (if provided as we recommend) to collect interest on overpayments of interest subsidies.

Our draft report contained a proposed recommendation that the Department's Office of Inspector General be required to develop audit standards for the guaranty agencies. The Department stated, however, that this responsibility rests with the Office of Postsecondary Education. While we agree that OIG does not have final responsibility for such standards, we believe—because of its experience and expertise in audit and review standards, procedures, and practices—it should be involved in the process of developing the standards. Therefore, we have modified our recommendation to clarify that OIG's role should be to assist in the development process.

In response to our recommendation that lender audits provide a statistically valid basis for recovering overpayments, the Department stated that it was instructing the agencies that, when significant errors by lenders are found, such methods must be used to recover overpayments. The Department also advised us that it is considering requiring the use of statistically valid estimation techniques in all agencies' lender reviews.

Our draft report contained a proposed recommendation that the Secretary revise the GSLP regulations to require lenders to (1) specify to their independent auditors that the verification of loan accounts and interest and special allowance billing be included in periodic independent financial audits and (2) provide that errors identified are promptly reported to the Department and the guarantee agency. The Department stated that it does not require lenders to have independent audits and believes the scope of such audits is the responsibility of regulatory agencies. It therefore believes that our recommendation should be addressed to the Congress for legislative action. We agree and have redirected our recommendation accordingly.

Consumer Bankers Association Comments

The Consumer Bankers Association had no major problems with the contents of our draft report. However, it stressed that the complexity of the billing system was a major cause of errors, and pointed out that lenders frequently make adjustments to correct prior period billing errors. We recognize the complexity of the billing system and the purpose of adjustments, and discuss each in the report. In fact, the complexity of the process is one of the major reasons we believe incentives, such as interest on overpayments, are needed to encourage lenders to exercise more care in preparing their billings.

The association objected to imposing penalties other than interest on lenders for overbillings, unless the overbillings resulted from purposeful distortion or gross negligence. We did not recommend that penalties (beyond those the Department currently has the authority to impose) be assessed in addition to interest for overbillings. Rather, we suggested that the penalties provide for the payment of interest for the time it takes the lenders to make adjustments and repay the overpayments.

The association also noted that the National Student Loan Data System[1] should provide for improved oversight of lenders. As we noted in two recent reports,[2] the data system—if fully implemented—should help prevent fraud and abuse by borrowers. However, guaranty agencies are not currently required to use the system, and it may be some time before it is implemented. Furthermore, such a system would not relieve lenders from the responsibility for preparing accurate interest subsidy billings.

[1] A nationwide computerized data bank that the Department is authorized to establish; it is to contain information on student loan indebtedness and institutional lending practices.

[2] Guaranteed Student Loans: Legislative and Regulatory Changes Needed to Reduce Default Costs (GAO/HRD-87-76, Sept. 30, 1987); and Guaranteed Student Loans: Potential Default and Cost Reduction Options (GAO/HRD-88-52BR, Jan. 7, 1988).

Loans Outstanding for Lenders Included in GAO's Review (As of Sept. 30, 1985)

Dollars in millions

Lender	Kind of organization	Loans' principal balance
Albany Savings Bank,[a] Albany, New York	Bank	$33.3
Bank of America, Pasadena, California	Bank	129.6
Citibank,[b] Rochester, New York	Bank	1,587.1
Empire of America of Michigan, Southfield, Michigan	Savings and loan association	22.6
First Federal of Michigan Savings and Loan Association, Detroit, Michigan	Savings and loan association	14.8
First National Bank of Chicago, Chicago, Illinois	Bank	62.1
Florida Federal Savings and Loan Association, St. Petersburg, Florida	Savings and loan association	473.0
Home and City Savings Bank,[a] Albany, New York	Bank	25.4
Hughes Aircraft Employees Credit Union, Manhattan Beach, California	Credit union	14.3
Illinois Designated Account Purchase Program, Deerfield, Illinois	Secondary market/state agency	113.0
Manufacturers National Bank, Detroit, Michigan	Bank	55.8
Michigan Higher Education Student Loan Authority, Lansing, Michigan	State agency	174.7
Northern Trust Company, Chicago, Illinois	Bank	19.5
Student Loan Marketing Association/AFSA Data Corporation[c] Long Beach, California	Secondary market/ servicing agent	1,053.5
Student Loan Marketing Association/Cybernetics and Systems, Inc.,[c] Jacksonville, Florida	Secondary market/ servicing agent	195.2
Southern Educators, Norcross, Georgia	Life insurance company	10.9
Total		**$3,984.9[d]**

[a]Interest and special allowance billing prepared by New York State Higher Education Service Corporation, the state guaranty agency.

[b]Interest and special allowance billing prepared by New York State Higher Education Service Corporation only for those loans guaranteed ($406.5 million). The bank billed directly for the remainder of its portfolio.

[c]These contractors are under contract with the Student Loan Marketing Association to prepare billing statements for interest and special allowance.

[d]This is 10.8 percent of the $36.8 billion of guaranteed student loans outstanding at September 30, 1985.

Interest and Special Subsidy Allowance Billed by Lenders Included in GAO's Review (for the Quarter Ending Sept. 30, 1985)

Lender	Subsidized interest	Special allowance	Total
Albany Savings Bank	$331,685	$248,000	$579,685
Bank of America	2,171,343	723,520	2,894,863
Citibank	18,136,661	9,981,011	28,117,672
Empire of America Savings and Loan	300,024	147,641	447,665
First Federal Savings and Loan	235,612	107,283	342,895
First National Bank	934,695	379,822	1,314,517
Florida Federal Savings and Loan	6,020,871	2,893,429	8,914,300
Home and City Savings Bank	249,279	174,566	423,845
Hughes Aircraft Credit Union	124,013	116,889	240,902
Illinois Designated Account Purchase Program	386,981	573,604	960,585
Manufacturers National Bank	751,037	380,387	1,131,424
Michigan Higher Education	1,717,833	1,034,219	2,752,052
Northern Trust Company	190,436	145,227	335,663
Sallie Mae-AFSA Data Collection	9,389,392	8,286,916	17,676,308
Sallie Mae-Cybernetics and Systems	1,738,101	1,376,233	3,114,334
Southern Educators	106,823	70,614	177,437
Total	**$42,784,786**	**$26,639,361**	**$69,424,147**

Accounts in Which Lenders Miscalculated Loan Balances or Interest Due

Reason	Number of accounts	Amount overbilled
Incorrect loan balances:		
Loans billed as in-school that actually were in repayment	11	$1,066
Balances included nonsubsidized loans	23	936
Loans erroneously included on billing after default claim paid by guaranty agency	3	85
Loans included on billing before disbursement	7	148
Other	3	5
Total loan balance errors	**47**	**2,240**
Incorrect interest calculations:		
Amount incorrectly computed	84	4,012
Inappropriate adjustments	40	1,705
Other	6	94
Total interest calculation errors	**130**	**5,811**
Total	**177**	**$8,051**

Comments From the Department of Education

UNITED STATES DEPARTMENT OF EDUCATION
OFFICE OF THE ASSISTANT SECRETARY FOR POSTSECONDARY EDUCATION

JUN 16 1988

Mr. Lawrence H. Thompson
Assistant Comptroller General
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Thompson:

The Secretary asked that I respond to your request for our comments on your draft report entitled "Guaranteed Student Loans: Lenders' Interest Billings Often Result in Overpayments," GAO/HRD 88-72, Dated April 29, 1988.

The enclosed response provides a general overview to the audit and addresses specific recommendations made to the Congress and to the Department of Education.

We appreciate the opportunity to comment on this draft report before its publication.

Sincerely,

Kenneth D. Whitehead
Acting Assistant Secretary

Enclosure

400 MARYLAND AVE., S.W. WASHINGTON, D.C. 20202

GAO Draft Report, "Guaranteed Student Loans:
Lenders' Interest Billings Often Result
In Overpayments," (GAO/HRD 88-72),
Dated April 29, 1988

General Overview

The Department of Education believes the Draft Report presents a thoughtful analysis of both the scope of the problems associated with Guaranteed Student Loan (GSL) lender billings and many of the conditions which have inhibited the Department from sufficiently dealing with interest billing errors. However, the report, in our opinion, offers a somewhat less compelling analysis of methods to resolve the problems.

In the following section, we discuss each of the Draft Report's specific recommendations. As a general observation, we believe that the recommendations, if fully adopted, would address some of the problems associated with interest billing errors. However, it should be noted that we do not view the recommendations contained in the Draft Report as the only solution to the problems described.

We believe that the recently completed GSL Quality Control Project, currently under Departmental review, and cited in the Draft Report, is a necessary step in assessing the systemic problems which prevent the Department from significantly reducing its financial vulnerability, increasing participant accountability, and exploring options for addressing such problems in the long term. Several of the Draft Report's recommendations, such as the imposing of penalty interest on overbilling, if combined with longer term strategies to improve the current program delivery processes, would, together, act to enhance the Department's capability of discovering lender payment error, and to reduce the occurrence of error.

We must take exception to the fact that, throughout the report, when comparisons are made between GAO's audits of the 16 lenders and "typical" Department lender reviews, the impression is given that the current lender reviews conducted by the Department (and the Guarantee Agencies) may be characterized as being of minimal usefulness. We believe that the provision in the Department's regulations at 34 CFR § 682.410 requiring guarantee agencies to perform reviews of major lenders, in conjunction with the Lender Site Review Guide referenced in the Draft Report and the Department's training of the guarantee agencies in this function, have resulted in an enhanced review process. Although there is no guarantee that the scope of the reviews is identical throughout all regions, we are striving to standardize the review function as much as possible.

As a final general comment, we note that the revised interest billing subsystem, which is presently scheduled for completion on October 1, 1989, (rather than October 1, 1988, as cited in the Draft Report) is expected to improve the Department's ability to detect interest billing errors by way of enhanced edits and improved controls.

We now discuss the individual recommendations:

Recommendations to the Congress

GAO recommends that the Congress amend the Higher Education Act to provide the Secretary of Education authority to assess lenders penalty interest on overpayments of interest and special allowance due to lender billing errors.

Response

We believe the Department currently has the authority to assess interest on overpayments received by lenders. However, that authority is not specifically contained in the program statute and we therefore do not oppose a change in the statute.

In general, the Department's authority to penalize lenders and guarantee agencies for violation of program requirements is inhibited by S 432(g)(3) of the Higher Education Act which allows lenders and guarantee agencies to avoid liability by correcting violations before the Department institutes action. The Department, in its student aid accountability bill, (The Student Aid Integrity and Accountability Amendments of 1988), is attempting to repeal this defense and we recommend that GAO urge Congress to support the repeal of this defense.

Recommendations to the Secretary

Recommendation 1

GAO recommends that the Secretary revise the GSL Program regulations to require the Office of the Inspector General (OIG) to develop audit standards for the guarantee agencies to use in reviewing lenders' billing systems and practices.

Response

The GAO has confused the term "audit" with the term "program review". Guarantee Agencies conduct program reviews, not audits. We do not believe the OIG should be asked to develop program review standards. That responsibility rests with the Department's Office of Postsecondary Education, (OPE) and as is explained below, has been accomplished.

Lenders with large GSL portfolios are now subject to regular comprehensive program reviews by guarantee agencies under 34 CFR 682.410. The Department distributed the Lender Site Review Guide to guarantee agencies in the fall of 1987 to assist them in conducting these reviews. The Site Review Guide distribution was followed up by extensive training for all guarantee agencies in the lender and school review functions. These 3-day training sessions, held in three locations, were attended by representatives of all agencies (except Puerto Rico - which will receive individualized instruction this spring). Additional training will be held this fall and the Department will also provide ongoing technical assistance to the guarantee agencies.

Recommendation 2

GAO recommends that the Secretary revise the GSL Program regulations to stipulate that the Department and guarantee agency audits of lenders include tests of the accuracy of lender loan accounts and billing statements to provide a statistically valid basis for recovering overpayments.

Response

The Department intends to issue a "Dear Colleague" letter to clarify the regulatory requirement that a guarantee agency conduct comprehensive biennial on-site program reviews of its major lenders. This letter will specifically note that agencies are required to review the accuracy of the lender's billings. If significant errors are found, the agency must ensure that either the agency or the lender determines the amount of liability owed to the Department by statistically valid methods, and must seek repayment of that liability to the Department.

The Draft Report does not acknowledge the fact that many errors in lender billings are found through an examination of the lender's interest billing system and procedures. A review of individual borrower files can disclose certain errors, such as late conversions. However, we do not believe that borrower files should be reviewed to the exclusion of an examination of the overall system. We fear that placing too great an emphasis on the review of borrower files may lessen the review of other equally important components of the interest billing process. Nevertheless, the Department is considering amending current regulations to require the use of statistically valid estimation techniques by agencies in conducting all lender reviews.

Recommendation 3

GAO recommends that the Secretary revise the GSL Program regulations to require lenders to (1) specify to their independent auditors that the verification of loan accounts and interest and special allowance billing be included in periodic independent financial audits, and (2) provide that errors identified are promptly reported to the Department and guarantee agency.

Response

The Department does not require independent audits of lenders. We believe this issue is more appropriately in the jurisdiction of lenders regulatory agencies. For this reason, we believe that this recommendation should be addressed to Congress for action specifically to revise section 435(d)(1)(A) and (C) of the Act to require that regulated lenders be subject to examination and supervision that includes the lenders' GSL activities.

Comments From the Consumer Bankers Association

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G. RUSSELL HATCHL*
OF COUNSEL

June 6, 1988

Mr. Joseph J. Eglin
General Accounting Office
Human Resources Division
Washington, D.C. 20548

Dear Mr. Eglin:

Subject: Comments on GAO Report

Thank you for the opportunity to review the draft GAO Report entitled "Guaranteed Student Loans: Lenders Interest Billings Often Result in Overpayments." In response to your request for comments, I shared, on a confidential basis, a copy of the report with approximately five GSL lenders.

Generally speaking, the lenders had no major problems with the contents of the report. However, two lenders noted that the report failed to explain the normal processing of adjustments on 799 billings and the fact that such adjustments frequently result in corrections of overbillings made on 799 forms.

Lenders also objected to the suggestion that the Department lacked authority "to penalize lenders for incorrect billings." The preparation of a 799 can be an exceptionally complicated process, especially for small lenders. Upon discovery of a 799 billing error, the Department can and does request correction of the error. Penalties in addition to interest on amounts incorrectly received for errors in the 799 billing should be restricted to cases where either purposeful distortion of account data or gross negligence resulted in an overbilling.

In addition, lenders believe that current bank regulations and increasing scrutiny by the Department of Education in recent months does provide additional incentive for lenders to accurately bill for interest subsidies. We recommend that the final report be modified to delete reference to lenders "lacking incentives." To the extent that modifications to the current billing process are needed, lenders would agree that the Department should be authorized to charge interest against lenders on amounts inappropriately billed. No additional penalty is necessary to modify current practices.

The report should also reflect that the Department is shifting accounting for special allowance and interest benefits to the average daily balance method. This shift, while a burden to many medium and small size lenders, will result in increased accuracy in 799 billings processed by the Department.

Finally, the report should be modified to include a more in-depth analysis of the causes of inaccuracies in 799 billings. Lenders believe that the constantly increasing complexity of the GSL program is resulting in increasing difficulty, especially on the part of small lenders, to maintain appropriate documentation of loan status in all cases. For example, student status reports frequently are subject to numerous adjustments because of delays in appropriate account data being transmitted to the lender by students, guarantors and others. With each retroactive adjustment in the status of the loan, an opportunity for an error in special allowance and interest billing is created. The report should suggest that the current complexity of the GSL program is contributing to the task of preparing Form 799. It is becoming increasingly subject to error even on the part of lenders placing a high priority on accuracy in the form.

It should be noted in the report that the implementation of the National Student Loan Data System will give the Department an additional opportunity to cross-check the status of a particular holder of a GSL, and that the use of the National Student Loan Data System for this purpose should be considered in making final system design decisions for the System.

I hope these brief comments are of use to you as work on the report continues. Thank you again for a chance to review the draft.

Sincerely,

Consumer Bankers Association
John E. Dean
Special Counsel

cc: Craig Ulrich, Esq.

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